

CLERK, U.S. BANKRUPTCY COURT  
DISTRICT OF OREGON

JUN 21 2004

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UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF OREGON

In Re: ) Bankruptcy Case No.  
          ) 04-61005-fra11  
WORLD FAMOUS, INC., )  
                                  ) Debtor. )  
\_\_\_\_\_  
KEYBANK NATIONAL ASSOCIATION, ) Adversary Proceeding No.  
                                  ) 04-6087-fra  
                                  ) Plaintiff, )  
                                  ) vs. )  
                                  ) )  
WORLD FAMOUS, INC.; N. KENNETH ) MEMORANDUM OPINION  
16 PHILLIPS; MACHEL T. PHILLIPS, )  
                                  ) Defendants. )

Plaintiff commenced an action to collect a debt owed to it,  
and to foreclose a security agreement securing that debt.<sup>1</sup> The  
Defendants have advanced several defenses and counterclaims.  
Plaintiff now moves for summary judgment on the claims set out in

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<sup>1</sup> The case was commenced in the Circuit Court for Jackson County, Oregon,  
and then removed to the United States District Court for the District of Oregon.  
It was removed to this Court by World Famous, Inc., after its petition for relief  
under Chapter 11 of the Bankruptcy Code. While maintaining that this is not a  
core proceeding, plaintiff consents to entry of dispositive orders and judgment  
by this Court. Defendant World Famous' consent is implicit in its removal of the  
case. Defendants Phillips have not been heard from on this point.

1 its complaint. Defendants resist, asserting that the Plaintiff has  
2 failed to observe a duty of good faith and fair dealing implicit in  
3 the contract. Since there appear to be no disputed material facts,  
4 and Defendants advance no evidence supporting their theory, I find  
5 for the Plaintiff.

#### 6 I. BACKGROUND

7 Plaintiff is a national bank doing business in Oregon, and  
8 elsewhere. Defendant World Famous, Inc., is a used car dealer,  
9 doing business in Jackson County, Oregon, as World Famous Autos.  
10 Defendants Phillips are shareholders of World Famous, Inc., and its  
11 guarantors with respect to Plaintiff.

12 World Famous first borrowed from Plaintiff in August of 2000.  
13 The loans were renewed on July 16, 2002.

14 As is typical in commercial lending, the transaction involved  
15 several different documents, each of which was dated July 16, 2002:

16 1. A business loan agreement establishing a line of credit,  
17 general requirements for security, representations of the borrowers,  
18 and conditions of individual advances. In particular, the agreement  
19 contained the following provisions:

20 Borrower understands and agrees that: ...(B) The  
21 granting, renewing or extending of any loan by lender  
22 at all times shall be subject to lender's sole  
23 judgment and discretion.

24 Conditions precedent to each advance:

25 (7) There shall not exist at the time of any advance a  
26 condition which would constitute an event of default  
under this agreement....

No event of default: There shall not exist at the time  
of any advance a condition which would constitute an

1 event of default under this agreement or under any  
2 related document.

3 Default. Each of the following shall constitute an  
4 event of default under this agreement:

5 Payment default. Borrower fails to make any  
6 payment when due under this loan.

7 \* \* \*

8 Insecurity. Lender in good faith believes itself  
9 insecure.

10 2. A promissory note dated July 16, 2002, in the principal  
11 sum of \$3 million. The promissory note by its terms required  
12 repayment of all outstanding principal plus all accrued interest on  
13 May 15, 2003.

14 3. A commercial security agreement and a commercial pledge  
15 agreement, each dated July 16, 2002, granting a security interest to  
16 the Bank in World Famous' inventory, chattel paper, accounts,  
17 equipment, general intangibles, contract rights, furniture and  
18 machinery, and an assignment to the Bank of all accounts and  
19 contract receivables due to World Famous.

20 4. A commercial swap agreement providing for the occasional  
21 adjustment of amounts due based on the fluctuation of interest  
22 rates; and

23 5. Personal guaranties executed by N. Kenneth Phillips and  
24 Machel T. Phillips. The guaranties are unlimited in amount, and  
25 provide for the absolute and unconditional promise to pay to Key  
26 Bank any indebtedness of World Famous, Inc.

Each of the agreements provides that it is to be construed  
under Oregon law and each contains a default provision providing

1 that a failure to comply with any of the other instruments  
2 constitutes a default of that agreement.

3 It is undisputed that World Famous has not paid the amount  
4 due under the promissory note as of May 2003. World Famous has also  
5 discontinued payments required under the swap agreement. These acts  
6 constitute defaults under the promissory note and swap agreement,  
7 the business loan agreement, and security agreements.

8 In addition, Bank alleges, without contradiction, that World  
9 Famous has overdrawn its checking account with Key Bank in the  
10 amount of \$3,040.07.

11 The guaranties have not been revoked by either Kenneth or  
12 Machel Phillips.

13 Defendants do not dispute any of the foregoing. In their  
14 defense, they allege<sup>2</sup> that the banking relationship was initiated  
15 after an aggressive marketing effort by Key Bank to win their  
16 business away from another bank. At the time the lending  
17 relationship was established in 2000, an officer of Key Bank  
18 represented that the Bank would serve World Famous "for the  
19 indefinite future." It was Mr. Phillips' expectation that Key Bank  
20 would in fact do so, and would be available to provide higher limits  
21 as World Famous' business continued to expand. The loans were, in  
22 fact, renewed in 2001 and 2002. Where the initial loan had been for  
23 \$1,250,000, the 2002 renewal was for \$3 million.

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24  
25 <sup>2</sup>Defendants' only evidentiary submission in opposition to the motion for  
26 summary judgment is the affidavit of defendant N. Kenneth Phillips. This  
memorandum assumes that all the allegations contained in the affidavit are true.

1           Near the end of 2002, Plaintiff notified World Famous that it  
2 would not renew the line of credit upon expiration of the 2002  
3 promissory note in May, 2003. It was explained to the Defendants  
4 that Plaintiff was discontinuing its business of lending to "buy  
5 here pay here" car sales companies "due to a loss incurred in a  
6 transaction with another such dealership." (Phillips' affidavit,  
7 page 10, paragraph 24.)

8           Defendants point out that, at the time they were informed  
9 that the loan would not be renewed, World Famous was current in all  
10 of its obligations to Key Bank, and in compliance with all non-  
11 monetary obligations under the several loan agreements. Defendants  
12 further allege that Defendants' eligible accounts were "well in  
13 excess" of the amounts required to support continued funding under  
14 the loan agreements.

15           World Famous immediately began a search for a source of  
16 continued financing. Mr. Phillips alleges that the efforts may have  
17 failed because an officer of the Bank had informed a loan broker of  
18 World Famous' needs, and that the loan broker "took it upon himself"  
19 to contact other potential lenders. "Whether his actions poisoned  
20 other lenders against World Famous we do not know for sure, but  
21 World Famous was turned down by a half dozen local banks that it  
22 contacted for financing." (Phillips' affidavit, page 10, paragraph  
23 26.)

## 24                           II. MOTION FOR SUMMARY JUDGMENT

25           Summary judgment is appropriate when the pleadings,  
26 depositions, answers to interrogatories, admissions, and affidavits,

1 if any, show that there is no genuine issue of material fact and the  
2 moving party is entitled to judgment as a matter of law. Fed. R.  
3 Civ. P. 56, made applicable by Fed. R. Bankr. P. 7056. The movant  
4 has the burden of establishing that there is no genuine issue of  
5 material fact. Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986).  
6 The primary inquiry is whether the evidence presents a sufficient  
7 disagreement to require a trial, or whether it is so one-sided that  
8 one party must prevail as a matter of law. Anderson v. Liberty  
9 Lobby, Inc., 477 U.S. 242, 247 (1986).

10 A party opposing a properly supported motion for summary  
11 judgment must present affirmative evidence of a disputed material  
12 fact from which a factfinder might return a verdict in its favor.  
13 Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 257 (1986).  
14 Fed.R.Bankr.P. 7056, which incorporates Fed.R.Civ.P. 56(e), provides  
15 that the nonmoving party may not rest upon mere allegations or  
16 denials in the pleadings, but must respond with specific facts  
17 showing there is a genuine issue of material fact for trial. Absent  
18 such response, summary judgment shall be granted if appropriate.  
19 See Celotex Corp. v. Catrett, 477 U.S. 317, 326-27 (1986).

20 Counsel for Defendants states in Defendants' response to the  
21 motion for summary judgment in U.S. District Court that Defendants  
22 have not had sufficient time to conduct discovery. The case was  
23 commenced in August 2003, removed to U.S. District Court in  
24 September 2003 where Plaintiff's motion for summary judgment was  
25 filed, and removed to this court in March 2004. No explanation is  
26 offered to show why discovery could not have been made during this

1 time. The court finds that Defendants have had more than enough  
2 time to obtain additional affidavits to supplement their opposition  
3 to Plaintiff's motion. No additional time will be granted.

### 4 III. DISCUSSION

#### 5 A. Fraud in the inducement.

6 Defendants allege that the loan agreements are avoidable as  
7 having been induced by fraud. The elements of fraud under Oregon law  
8 are:

9 1) the accused had falsely represented a material  
10 fact; 2) the accused knew that the representation was  
11 false; 3) the misrepresentation was made with the  
12 intent to induce the recipient to act or refrain from  
acting; 4) the recipient justifiably relied on the  
misrepresentation; and 5) the recipient was damaged by  
that reliance.

13 Pollock et al. v. Horton et al., 190 Or.App. 1,20, 77 P.3d 1120,  
14 1131 (2003) (internal citations omitted).

15 Defendants present no evidence in their affidavit opposing  
16 summary judgment to support their fraud theory. Broad promises of a  
17 fruitful and lasting commercial relationship made in an effort to  
18 obtain business do not constitute fraudulent representations. See  
19 generally Holland v. Lentz, 239 Or. 332, 344-346, 397 P.2d 787, 793-  
20 794 (1964) (discussion of dealer "puffing."). Moreover, if a party to  
21 an allegedly fraudulent contract wishes to disaffirm and rescind the  
22 contract, he must be prepared to restore the other party to the  
23 status quo. Bodenhamer v. Patterson, 278 Or. 367, 376-377, 563 P.2d  
24 1212, 1217-1218 (1977). Defendants make no offer to restore to the  
25 Bank the money it advanced.

26 // // //

1 B. Good faith and fair dealing.

2 Defendants take the position that Plaintiff failed to comply  
3 with covenants of good faith and fair dealing implicit in every  
4 agreement under Oregon law, citing to Best v. U.S. National Bank,  
5 303 Or. 557, 562, 739 P.2d 554, 562 (1987). In his opposing  
6 affidavit, Kenneth Phillips avers that it was not within his or the  
7 other Defendant's "reasonable expectations" that the Bank would  
8 refuse to renew the credit line under the circumstances existing at  
9 the time. It follows that the Bank has not complied with the common  
10 law standard, as defined by Oregon's courts.

11 1. Good faith requirement under Oregon common law.

12 Under Oregon law "every contract imposes upon each party a  
13 duty of good faith and fair dealing in its performance and its  
14 enforcement," Restatement (Second) Contract § 205 (1981), Tolbert v.  
15 First National Bank of Oregon, 312 Or. 485, 492, 823 P.2d 965, 969  
16 (1991); Pacific First Bank v. New Morgan Park Corp., 319 Or. 342,  
17 876 P.2d 761 (1994); Uptown Heights Assoc. Limited Partnership v.  
18 SeaFirst Corp., 320 Or. 638, 891 P.2d 639 (1995). This test has  
19 been described as an "objective" test, in which the court looks to  
20 the objectively reasonable expectations of the parties in  
21 determining whether the obligation of good faith has been met.  
22 Tolbert, *supra*, Uptown Heights Associates, 891 P.2d at 645.

23 Defendants' opposing affidavit does not disclose facts which  
24 would lead one to believe that their expectations that Key Bank  
25 would continue to lend indefinitely were objectively reasonable. It  
26 is not plausible to assert that, whatever advantage or disadvantage



1 there may be to the Bank, the Bank would continue the relationship  
2 "indefinitely." That being said, it appears that the objective  
3 test is not properly applied in this case in any event.

4 2. Good faith under the Uniform Commercial Code.

5 Article 9 of the Uniform Commercial Code, as enacted in  
6 Oregon, applies to:

7 a. A transaction, regardless of its form, that  
8 creates a security interest in personal property or  
fixtures by contract;

9 ORS 79.0109. Note that the Code's language speaks not of individual  
10 agreements or instruments, but of the transaction. It follows that  
11 UCC's standards respecting covenants of good faith apply to all the  
12 instruments of the transaction, and not simply the security  
13 agreements.

14 The general good faith obligation under the Uniform  
15 Commercial Code is found in Oregon in ORS 71.2030:

16 **Obligation of good faith.** Every contract or duty  
17 within the Uniform Commercial Code imposes an  
18 obligation of good faith in its performance or  
enforcement.

19 Good faith is defined in ORS 71.2010(19) as "honesty in fact  
20 in the conduct or transaction concerned."

21 Under Oregon law the duty of good faith created by the  
22 Uniform Commercial Code displaces the common law duty of good faith.  
23 U.S. National Bank of Oregon v. Boge, 311 Or. 550, 814 P.2d 1082  
24 (1991). The Boge court points out that the subjective standard set  
25 out in the UCC "does not encompass commercial reasonableness or the  
26 broader concept of good faith under the common law." Id.

1 In an extensive analysis of the structure of the Uniform  
2 Commercial Code, the Boge court concluded that the UCC's subjective  
3 test completely supplants the common law duty of good faith  
4 discussed in Best and other cases applying Oregon common law. The  
5 court found that the language of the statute suggests that the  
6 statutory definition was meant to be both uniform and complete, and  
7 that there is no room to import an objective standard from the  
8 common law into Article 9 transactions.

9 The subjective standard of the UCC does not look to the  
10 expectations of the parties, or the absence of negligence, or the  
11 standards of a reasonable and prudent person. As one commentator  
12 put it, all that is necessary is "a pure heart and an empty head."  
13 Bailey, Oregon Uniform Commercial Code § 1.12(1990). See Community  
14 Bank v. Ell, 278 Or. 417, 564 P.2d 685 (1977).

15 Defendants point to no evidence that Plaintiff was  
16 consciously dishonest in fact in its dealings with World Famous.  
17 Defendants rely on an incident in which an employee of the Bank  
18 suggests that Mr. and Mrs. Phillips' failure to engage the Bank's  
19 services for estate planning might adversely affect their  
20 relationship with the Bank. Assuming (as I must) that the words  
21 were said, and assuming further that they were true, the Bank's  
22 determination to discontinue its business relationship because  
23 Defendants declined to expand it along the lines that the Bank  
24 desired is not a breach of any duty of good faith under the UCC. If  
25 the Bank has the right under the contract itself to act as it did,  
26 its motive is irrelevant, since the obligation to act in good faith

1 does not bar a party from enforcing explicit legal rights that it  
2 possesses under an agreement. Boge, 311 Or. at 558, 814 P.2d at  
3 1092.

4 The promissory note is due by its terms, and the Bank acted  
5 within explicitly defined rights in the lending agreement when it  
6 declined to authorize a new loan. The obligation of good faith  
7 imposed by ORS 71.2030 cannot be used by the Defendants to change  
8 the terms of the contract or deprive Plaintiff of a right they  
9 granted to it when they executed the agreements. As the Boge court  
10 put it:

11 The obligation of good faith does not vary the  
12 substantive terms of the bargain...nor does it provide  
13 a remedy for an unpleasantly motivated act that is  
expressly permitted by contract....

14 Boge, 311 Or. at 567, 814 P.2 at 1092.

15 Phrased differently, it is not appropriate under Oregon law  
16 to apply the general obligation of good faith if it is inconsistent  
17 with an explicit provision of the contract. Boge, supra; Sheets v.  
18 Knight, 308 Or. 220, 233, 779 P.2d 1000, 1008 (1989) (internal  
19 citation omitted).

#### 20 IV. CONCLUSION

21 The Agreements entered into by Debtor are in full force and  
22 effect and the Debtor is in default of those agreements. An order  
23 will be entered granting Plaintiff's motion for summary judgment on  
24 each of the claims contained in its Complaint. It appears from the  
25 affidavits and evidentiary materials submitted that there may not  
26 have been a meeting of the minds with respect to the LIBOR Swap

1 Agreement signed by Mr. Philips. That issue will therefore be dealt  
2 with at trial. Trial will also be held on Defendants'  
3 counterclaims, with the exception of the claim for fraud which is  
4 necessarily disposed of by this holding.

5 This memorandum constitutes the Court's findings and  
6 conclusions of law. Counsel for Plaintiff shall submit a form of  
7 order consistent with this ruling.

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11 FRANK R. ALLEY, III  
12 Bankruptcy Judge  
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